United States Court of Appeals

for the Second Circuit

APPELLANT'S PETITION FOR REHEARING EN BANC

75-7608

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT

Docket No. 75-7608

B

IRVING SANDERS, *Plaintiff-Appellee,*

—against—

LEON LEVY, *et al., Defendants-Appellants.*

P/S

EGON TAUSSIG, *Plaintiff-Appellee,*

—against—

SIDNEY M. ROBBINS, *et al., Defendants-Appellants.*

MICHAEL SHAEV and RITA SHAEV, *Plaintiffs-Appellees,*

—against—

ERIC HAUSER, *et al., Defendants-Appellants.*

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF OF DEFENDANTS-APPELLANTS OPPENHEIMER MANAGEMENT CORP., OPPENHEIMER & CO., LEON LEVY AND JACK NASH ON HEARING EN BANC

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STATEMENT OF CASE

Preliminary Statement

This is a rehearing en banc upon grant of the petition of plaintiffs-appellees for rehearing pursuant to Rules 35 and 40 of the Federal Rules of Appellate Procedure of the decision of this Court dated June 30, 1976 insofar as it reversed an interlocutory order and decision of the United States District Court for the Southern District of New York (Griesa, J.) issued in connection with plaintiffs' motion for class action treatment of certain claims herein.

The District Court decided, among other things, that the action was properly maintainable as a class action under FRCP Rule 23(b)(3), and it directed defendant-appellant Oppenheimer Fund, Inc. to pay the substantial costs involved in preparing programs to extract from computer tapes the names and addresses of prospective class members in order to enable plaintiffs to meet the obligations imposed on them by FRCP Rule 23(c)(2) to give class members notice of the pending action.

The Court of Appeals for the Second Circuit (per Judges Hays, Mulligan and Palmieri) in an opinion written by Judge Palmieri unanimously affirmed the designation of the suit as a

67,726,541 shares were outstanding, the Fund had net assets of

class action and reversed (Hays, J. dissenting) so much of the District Court order as directed defendant Oppenheimer Fund, Inc. to bear the cost of devising computer programs to extract the names and addresses of the class members.

The decision of the District Court appears at page 169 of the Appendix and its Memorandum Order appears at page 188. The text of FRCP Rules 23(b)(3) and 23(c)(2) are set forth in an addendum at the end of this brief.

Summary of Proceedings in the District Court

Plaintiffs, shareholders of defendant Oppenheimer Fund, Inc. (the "Fund"), commenced three independent actions in 1969 which were consolidated for all purposes by order of the District Court. Plaintiffs, who have demanded a jury trial, seek to maintain this action on behalf of themselves and a class of 121,000 other shareholders of the Fund who acquired its shares during the two year period from March 28, 1968 through April 24, 1970.

The defendant Fund is an open-end investment company registered under the Investment Company Act of 1940. Fund shares are offered for sale and sold to the public on a continuing basis. Fund shares may be purchased at the public offering price which is based on the net asset value plus a stated service charge. Net asset value is the proportionate interest of a share in the value

of the Fund's assets, including its investment portfolio. Shareholders of the Fund who wish to liquidate their interest do so by selling the shares back to the Fund at net asset value (A-60, A-130-31).* Other defendants herein are Oppenheimer Management Corporation (the "Manager"), the investment adviser to the Fund; Oppenheimer & Co., a broker-dealer member firm of the New York Stock Exchange which controls the Manager, and individual directors of the Fund.**

The complaints herein (A-10, A-22, A-38) allege that defendants caused the Fund to overvalue restricted securities thereby inflating the net assets of the Fund and causing a concomitant overvaluation of Fund shares sold to the public and/or redeemed by the Fund and, in addition, causing the payment of excessive fees to the Manager under its investment advisory agreement with the Fund. Plaintiffs further claim that during the relevant period defendants caused the Fund to file prospectuses and issue periodic reports that failed to disclose adequately the acquisition of restricted securities, the methods employed in the

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* References are to pages in the Appendix filed herein.

** Individual defendants, not all of whom have been served, include Leon Levy, Jack Nash, Edmund T. Delaney, Hon. Emanuel Celler, Eric Hauser, Joseph M. McDaniel, Jr., Prof. Sidney M. Robbins and Murray Graham.

valuation of restricted securities and the limitations on the marketability of such restricted securities, in violation of the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940, the rules promulgated under said Acts and fiduciary obligations under state law. The complaints are brought individually on behalf of the plaintiffs and representatively on behalf of all persons who purchased Fund shares subsequent to March 15, 1968; in a separate count, each of the plaintiffs sues derivatively on behalf of the Fund to recover alleged overpayments made by the Fund in connection with redemption of Fund shares during the relevant period. The plaintiffs seek to recover for themselves and the class of Fund purchasers the amount of their claimed overpayments and they seek an accounting to the Fund for damages sustained by it in connection with the redemption of its shares and for all fees received by the Manager. The complaints further seek to have the investment advisory agreement and distribution contract between the Manager and the Fund voided and they also request an award of costs and disbursements, including fees of attorneys and accountants.

In their amended answers (A-47, A-59, A-73), defendants deny the material allegations of the complaints and assert various affirmative defenses. Among other things, the answers allege that restricted securities never exceeded 10% of the value of all

of the Fund's assets, that the restricted securities were at all times carried at their fair value as determined in good faith by the Board of Directors of the Fund as required under Section 2(a)(41)(B)(ii) of the Investment Company Act of 1940 and that there was fair, adequate and timely disclosure by the Fund of investments in restricted securities. In addition, the defendants have alleged that setoffs should be allowed to the extent that overvaluation of Fund securities resulted in receipt of benefits by plaintiffs or the Fund.

By motion dated March 30, 1973, plaintiffs applied to the District Court for an order authorizing the consolidated action to be maintained as a class action on behalf of all persons who purchased shares of the Fund during the period from March 28, 1968 to April 24, 1970 (A-116). The motion was decided on May 15, 1975 (A-169), after plaintiffs had taken the deposition of the Fund's transfer agent concerning the costs and methods of determining the names and addresses of would be members of this class. Thereafter, all parties moved for reargument and on October 1, 1975 there was filed the order of the Court which was appealed from by defendants (A-188).

Summary of Decision and Order of the District Court

In its opinion of May 15, 1975 (A-169), the District Court concluded that the action could be maintained as a class

action under FRCP 23(b)(3) and that the class should consist of all persons who purchased Fund shares between March 15, 1968 and April 24, 1970. The Court further decided that the Fund should bear the expense involved in providing to plaintiffs the names and addresses of class members to enable plaintiffs to mail the necessary class action notices and that plaintiffs would be responsible for preparing and mailing such notice.

The Court rejected defendants contentions that the action was not manageable as a class action. It also rejected plaintiffs' attempt to avoid the expense of identifying class members by limiting the class to those purchasers of Fund shares who were still current shareholders, whether or not class members. The Court also rejected defendants' claim that the class should be limited to those who purchased Fund shares before April 25, 1969.

After all parties moved for reargument, the Court entered a Memorandum Order (A-188) which corrected the opening date of the class to March 28, 1968; directed that the cost of identifying class members should be borne by the Fund without prejudice to its right, at the conclusion of the action, to make whatever claim it would be legally entitled to make for reimbursement by other parties; and authorized the mailing of the class notice, at plaintiffs' expense, in a regular Fund mailing provided the notice is sent only to class members.

Summary of Facts Relevant to the Class Notice and Manageability of the Action as a Class Action

As of March 31, 1973, when the motion for class action determination was made, the Fund had under management net assets of approximately $523,243,000. As of said date, there were 67,726,541 shares of the Fund outstanding owned by approximately 173,957 shareholder accounts, of which approximately 86,063 were direct shareholder accounts and 87,894 were shareholder accounts owned by planholders of Oppenheimer Systematic Capital Accumulation Program ("OSCAP") (A-131). OSCAP is an investment company of the unit investment trust type, registered under the Investment Company Act of 1940, which holds Fund shares on behalf of its planholders. OSCAP is organized as a custodianship which issues "plans" to participants, each plan representing an undivided interest in units of Fund shares. When the account of an OSCAP planholder is liquidated, the custodian sells the proportionate number of Fund shares to the Fund and the proceeds are credited to the OSCAP planholder.

Class Notice

During the period covered by plaintiffs' proposed class (i.e., March 28, 1968 through April 24, 1970), there were approximately 121,000 shareholder accounts which purchased Fund shares.

Of this total, 41,400 were new shareholder accounts of the Fund, 54,600 were new purchasers of OSCAP plans and 25,000 were shareholder accounts or holders of OSCAP plans which had previously owned Fund shares and acquired additional shares during the relevant period (A-133). However, there is a constant turnover of shareholder accounts and many accounts which acquired shares during the relevant period are no longer shareholders or planholders (A-139).

The names and addresses of the shareholder accounts of the Fund, including members of the class, are contained in magnetic computer tapes which are in the possession of Investment Company Services Corporation, the transfer agent of the Fund (A-195).* However, members of the class cannot be identified by a printout of existing tapes. New programs must be designed to scan shareholder and planholder computer records and machine processes must be employed by the transfer agent in order to extract from the

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* References are to the deposition of the Fund's transfer agent, Investment Company Services Corporation, by Messrs. Wouters and Sebastian, its Comptroller and Director of Systems and Programming, respectively, and additional information furnished by the transfer agent. The deposition was taken by plaintiffs' counsel on July 18, 1973; additional information, which was requested by plaintiffs' counsel during the course of the deposition, was forwarded by the transfer agent on October 10, 1973. The deposition and said additional information are not part of the Record on Appeal, but copies were submitted for the consideration of the Circuit Court on December 8, 1975, and pertinent portions are set forth in the Appendix.

existing tapes the names and addresses of the purchasers who acquired shares during the relevant period. It is the cost of such programming and procedures, with attendant labor costs, that make up the expense of identifying the names and addresses of members of the class (A-256).* As of October 10, 1973, the transfer agent estimated that these costs would total approximately $16,580. Needless to say, in the three years which have elapsed since that date, inflation has caused such costs to increase substantially.

Defendants maintained in the District and Circuit Courts that where, as in this case, the purpose of identifying members of the class is to enable plaintiffs to send the initial class notice required by FRCP Rule 23(c)(2), such cost is part of the notice cost which plaintiffs are required to bear.

Plaintiffs have declared that they will not bear the expense of identifying new class members and have stated that if they were required to pay such costs they would "be unable to continue prosecution of this consolidated action as a class suit" (A-144, A-147, A-149).

During the course of the protracted class motion proceedings in the District Court, the Supreme Court held that plaintiffs must bear notice costs in a class action. Eisen v. Carlisle & Jacquelin, 417 U.S. 156 (1974). Thereafter, plaintiffs sought to

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* See footnote on page 8.

avoid such costs here by attempting to modify the class description through elimination from the class of those persons who were not current shareholders at the time of mailing the class notice, and plaintiffs urged the District Court to direct that the notice could be inserted in a regular mailing sent by the Fund to all of its current shareholders (A-143-44, A-149-50). Defendants opposed the mailing of a class notice to all current shareholders on the grounds that such a mailing would have a serious adverse effect on the Fund, since there were many current shareholders who were not members of the class and such notice might well precipitate a substantial demand for redemption by them having some of the unfortunate effects of a run on a bank (A-138, A-140). It was in the context of opposition to the sending of a class notice to all current shareholders that the defendants opposed the proposed modification of the class (A-138-41, A-132-35). The defendants had no interest in enlarging the class in any other context, and indeed sought to have the class limited by a full year, to purchasers before April 25, 1969 (A-137).

After reviewing the arguments and evidence concerning the adverse impact of a mailing to all current stockholders, the Circuit Court concluded that "defendants' concern was legitimate ..." (Slip Op. p. 4587).

The District Court also rejected plaintiffs' proposal as prejudicial to class members in terms as follows (A-175):

> "... in my view, plaintiffs' proposal would involve an arbitrary reduction in the class. If the shareholders who purchased during the relevant period were misled into purchasing at inflated prices, then, as far as the present record shows, this problem affects those shareholders who have sold out just as much as those who happened to have retained their shares."

The District Court then went on to rule that the cost of identifying the class members was to be borne by the Fund, saying (A-175):

> "Whether this would be the correct allocation in other cases, I do not attempt to say. But here the expense is relatively modest and it is the defendants who are seeking to have the class defined in a manner which appears to require the additional expense."

We do not believe that the District Court's conclusion is sound on the facts or warranted by the law. The Circuit Court correctly pointed up oneflaw in the District Court's conclusion, declaring (Slip Op. p. 4586):

> "The class as originally defined was found to constitute the proper class for reasons unrelated to the interests of the defendants. It would thus be inconsistent to say that it is a proper class only if the defendants pay the costs. The two issues are distinct."

Another flaw is that the District Court's decision is based on the unarticulated premise that the cost of identifying members of a class is not an essential component of the notice costs which are required to be borne by plaintiffs in a class action. In addition, neither the plaintiffs, who have declared they would not maintain the action as a class action if required to bear this cost, nor defendants regard the sum involved as "relatively modest." Moreover, in attributing an enlarged class to defendants the Court misconstrued the defendants' position on a blanket mailing to all stockholders. Finally, if the notice is limited to class members, there is no basis for the Court's assumption that the cost of indentification would be materially different whether class members include all purchasers during the relevant period or only those who are current shareholders at the time of mailing the notice; on the contrary it would appear that the same computer programming and other procedures would be required in both cases.

Manageability of Action as a Class Action

The gravamen of the claims in this action is that restricted securities held in the Fund's portfolio were over-valued during the two year period 1968-1970. During this period, the Fund owned thirteen different restricted securities.

If this action proceeds as a class action, proof and findings will be required as to the extent of overvaluation, if any, of each of the thirteen restricted securities on substantially each of approximately 500 business days during the relevant two year period.* This complex skein of evidence will be required because shares of the Fund were sold and redeemed in substantial volume on almost every business day throughout the relevant period.** Thus, as to each of the 121,000 shareholder accounts which are members of the class, it will be necessary to ascertain each date on which such account purchased or otherwise acquired additional Fund shares (for example, through reinvestment of dividends) and each date on which such account sold Fund shares, in whole or in part, as well as the extent, if any, as to which each restricted security was overvalued or undervalued on such date. The liability of the defendants is individual to each class member and exists only if there was a net overvaluation of all restricted securities on the date of each particular purchase or sale of Fund shares.

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* On the oral argument before the Circuit Court, defendants corrected the erroneous references in their briefs to "200" business days.

** For example, sales and redemptions can range from 18,549 and 16,364 shares, respectively, on March 28, 1968 to sales and redemptions of 58,170 and 14,000 shares, respectively, on November 11, 1969.

The difficulties of determining whether the defendants are liable to any one or more of the 121,000 members of the class, and if so the extent of such liability in each case, will be exacerbated by the fact that plaintiffs have demanded a jury trial. The problems are further complicated by the relatively small dollar amounts on the average which will be involved. In response to defendants' interrogatories seeking to ascertain details as to plaintiffs' claims concerning the alleged overvaluations and the damages sustained by the class, plaintiffs claimed that by reason of the alleged overvaluations, the class members paid $1,481,000 more than was proper in connection with purchases of Fund shares, that the Fund overpaid $226,000 on account of redemptions, and that the Manager received excess management fees of $75,000 by reason thereof (A-160, A-164, A-165). This response, which was made by plaintiffs' counsel and verified by the plaintiffs (A-165-8), is substantially identical with estimates made by plaintiffs' counsel in an affidavit in July 1974, which estimates were admittedly based solely on counsel's alleged experience "regarding appropriate discounts forcomparable restricted securities", since plaintiffs conceded they had not retained an expert in connection with the determination of the fair value of the restricted securities (A-152).

Since plaintiffs have no expert basis for estimating damages, the reliability of the amounts may be questioned, and it may be assumed that their estimates do not err on the conservative side. Nevertheless, it is noteworthy that even on their own figures, the damages claimed for the average account would be no more than $12.24.* Even plaintiffs concede that on average, the damages are no more than $15.00 per account (Plaintiffs-Appellees Brief on Appeal, p. 9). In fact, the average recovery probably would be less, for plaintiffs' estimates do not appear to take into account the amounts which may be set off with respect to class members who have redeemed "overvalued" shares during the relevant period.

The defendants estimated that even if the restricted securities had been overvalued by as much as 10%, such overvaluation would have amounted to not more than 4/5 of 1% of the purchase price of Fund shares and as little as 1/5 of 1% of the purchase price, depending upon the time that the class member purchased his securities (A-131-32). As of March 31, 1973 when

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* As of March 31, 1973, 67,726,541 shares of the Fund were outstanding and were owned by approximately 173,957 shareholder accounts (A-131), for an average of 391 Fund shares per account. Thus, the average damages for the 121,000 shareholder accounts who may be members of the class approximates $12.24. As of the commencement of this action, plaintiffs Shaev and Sanders owned 45.071 and 209.823 shares, respectively, and accordingly their damages would be proportionately less than average. Plaintiff Taussig owned 2,369.363 shares at the commencement of the action and redeemed 337.39 during the relevant period (A-108, A-98, A-112-13).

67,726,541 shares were outstanding, the Fund had net assets of $523,253,571, or a net asset value per share of $7.72. At that time there were 173,957 shareholder accounts, or 391 shares per average account. Thus, the average net value of each account was approximately $3,000. If the range of 1/15 to 4/15 of 1% were applied to such average account, then the damages would range from $2.00 to approximately $24.00 per average account, depending upon the date of purchase of shares.

Because the litigation will be substantially prolonged by reason of the necessity of establishing, as to each member of the class, (i) whether or not there is any liability to such member and (ii) if there is any liability, the amount thereof and where, at most, the amount of damages which might be recovered on average is so insignificant, defendants urged in the District and Circuit Courts that neither the trial Court nor the litigants should be subjected to the burdens and expenses which would necessarily be incurred by permitting the action to be maintained as a class action.

Summary of Circuit Court Decision

The Circuit Court disposed of plaintiffs' contentions that the District Court order was not appealable by holding (1) that the order requiring the Fund to bear identification costs

was appealable under the collaterial order doctrine* and (2) that designation of the suit as a class action was also reviewable because, among other things, the order in which it was made was properly before the Court on another ground.** The Court's decision on appealability was unanimous.

The Court also held unanimously that the granting of class action status was proper. Despite the necessity for proof, day-by-day over a two year period that the Fund directors failed to value the thirteen restricted portfolio securities fairly and for proof of damages, if any, to purchasers, the Court found that common questions of law and fact predominated over individual questions and affirmed the lower Court saying that the District Court was "in the best position to determine manageability and has considerable discretion in doing so."

The Court divided only on the issue of allocation of the cost of ascertaining the names and addresses of class members for purposes of the class notice. The majority (Mulligan and Palmieri,JJ.) held that such costs are allocable to plaintiffs and directed reversal of the District Court order to this extent. The majority

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* Citing Cohen v. Beneficial Loan Corp., 337 U.S. 541 (1949) and Eisen IV - i.e., Eisen v. Carlisle & Jacqueline, 417 U.S 156 (1974).

** Citing numerous cases, including Eisen IV, supra.

noted that under the decision of the Supreme Court in Eisen IV, 417 U.S. 156 (1974) the cost of notice in a class action must be borne in the first instance by plaintiffs, and if plaintiffs do not accept this expense the class action cannot be maintained. While the Supreme Court did not foreclose that possibility that there might be exceptions to this rule, after careful review of the pertinent factors, including those raised by the dissent, the majority concluded (Slip Op. p. 4585):

> "In sum, we preceive no special circumstances in this case that would warrant shifting the costs of notification from the plaintiffs to any of the defendants."

The dissent (Hays, J.) contended that the relationship of the defendants to the class members was fiduciary in character and therefore that this was a valid basis for creating an exception to the rule of Eisen IV. The majority disagreed pointing out among other things that the Fund was only a nominal party to the class action and that the relationship of remaining defendants did not warrant an exception from the Eisen IV rule.

The only other point raised by the dissent was that the cost of ascertaining the names and addresses of class members is a cost of discovery, which may be allocated by the trial judge in his discretion. The majority rejected, this, declaring (Slip Op. p. 4587):

"However, we are of the opinion that the cost of obtaining the name and address to be affixed to the envelope does not differ in kind from the cost of printing the notice and of procuring, stuffing and posting the envelopes. Moreover, if the rules of discovery were applicable, it appears unlikely that they would require that defendants bear the identification costs here."

The majority noted that under Rule 33(c) FRCP protection was afforded parties from interrogatories where the burden of extracting information from business records is equally great for both sides and the records are made available to the party seeking discovery, and protection would similarly be available under Rule 26(c) if other methods of discovery were utilized. It pointed out that the dissent had apparently failed to distinguish between merely obtaining a computer printout from available data compilations and the necessity in this case to incur the expense of devising programs to scan the tapes to segregate the requisite information prior to any printout.

The balance of the Circuit Court's decision dealt with the rationale of the District Court for its decision and contentions raised by plaintiffs-appellees. It rejected as inappropriate under Eisen IV the justification of the District Court for imposing costs on the Fund on the ground that the expense was "relatively modest." It also rejected the District Court's conclusion that defendants were seeking to have the class defined in a manner which appears to require the additional expense. Since the District Court found

members of the class in this action does not involve the production

that exclusion of non-current stockholders from class membership would be arbitrary and the class as originally defined was the proper class for reasons unrelated to the interests of the defendants, the Circuit Court observed that it is inconsistent then to say that it is a proper class only if defendants pay costs.

In the circumstances, the Circuit Court held that defendants here, as in Eisen IV, may not be compelled to provide financial support for a class action against themselves even if plaintiffs are unwilling to pay this expense.

STATEMENT OF ISSUES

1. In a class action, is the substantial cost of ascertaining the names and addresses of class members for the purpose of enabling plaintiffs to send the initial class action required by FRCP 23(c)(2) a part of the cost of notice to be borne by plaintiffs or may the defendants (or some of them) be required to pay such costs of identification?

It is submitted that such expenses must be borne by plaintiffs even where, as here, plaintiffs have indicated that they will not maintain the actions if they must bear such identification costs.

2. Do the predominance and complexity of individual issues concerning liability and damages render this action

By virtue of Rule 33(c), ordinarily a party will not be

unmanageable as a class action?

It is submitted that this action is not manageable as a class action and should be dismissed as such.

SUMMARY OF ARGUMENT

In a class action, notice costs are required to be borne by plaintiffs. Imposition on defendants of the cost of ascertaining names and addresses of class members is contrary to FRCP Rule 23(c)(2) and prevailing decisional law, which establish that the identification of class members is an inherent part of the notice procedure. The cost of extracting the names and addresses of class members from records on tape cannot and should not be logically differentiated from the costs of printing the notice, procuring envelopes, stuffing the envelopes and postage which have all been held to constitute part of the cost of class notice. Although such information for notice purposes is outside the scope of discovery, such identification costs would similarly be chargeable to the plaintiffs under the federal discovery rules, if applicable, since they preclude compelling one party to make compilations or refine statistical information which the other party might accomplish for himself by obtaining the data in its raw form.

The circumstances here present warrant no exception from the usual notice cost rule.

The District Court improperly allocated the cost of class identification to the defendant Fund because it found that (i) the expense is relatively modest and (ii) the defendants' position on class definition resulted in additional expense of class member identification. Both conclusions are unsound.

The Circuit Court properly allocated such costs to plaintiffs.

Under the standards established by FRCP Rule 23(b)(3), this action is not authorized to be maintained as a class action. There is not a sufficient predominance of common questions of law and fact since the alleged liability of the defendants for alleged overvaluation of restricted securities is individual to each class member according to the date of his purchase or sale of Fund shares, and the asserted statutory violations cannot be adjudicated on a comprehensive class basis. Moreover, formidable problems of proof and findings of damages to individual class members, which on average are relatively minute, render this action unmanageable as a class action.

Class action status herein should be denied. If, nevertheless, this action is permitted to proceed as a class action, the plaintiffs should be directed to pay the costs of identifying the members of the class to whom notice is sent pursuant to Rule 23(c)(2).

creation of entirely new programs to work with existing material

ARGUMENT

POINT I

The Cost of Identifying Class Members to Whom Notice Must be Sent Pursuant to Rule 23(c)(2) Should be Borne by Plaintiffs

FRCP Rule 23(c)(2) provides in relevant part:

> "In any class action maintained under subdivision (b)(3), the court shall direct to the members of the class the best notice practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort." (Emphasis supplied)

The instant action is a class action maintained under subdivision (b)(3) of the Rule, namely, one in which the District Court found that the questions of law or fact common to the members of the class predominate over any questions affecting only the individual members (A-170).

It is now well established that in such a class action, notice of the action must be mailed to all class members who can be identified by name and address through a reasonable effort and that the cost of such notice must be borne in the first instance by plaintiff. This Rule was enunciated in this Circuit in "Eisen III", Eisen v. Carlisle & Jacquelin, 479 F. 2d 1005 (2d Cir. 1973), petition for rehearing en banc denied, 479 F. 2d 1020, and thereafter conclusively established by the Supreme Court in "Eisen IV", Eisen v. Carlisle & Jacquelin, 417 U.S. 156 (1974).

Both this Circuit and the Supreme Court made clear that if plaintiff did not accept this expense, the class action could not be maintained. Defendants may not be compelled to finance a class action against themselves. As the Supreme Court said in Eisen IV (417 U.S. at 179):

> "[T]he plaintiff must pay for the cost of notice as a part of the ordinary burden of financing his own suit."

In imposing the cost of identifying the shareholders on defendants in the instant case, the District Court stated as one of its reasons that "here the expense is relatively modest" (A-175).* Insofar as this may reflect sympathy for the unwillingness or inability of plaintiffs to meet the requisite costs, it is not consonant with the law. In Eisen IV, supra at 176, the Supreme Court stated:

> "There is nothing in Rule 23 to suppose that the notice requirements can be tailored to fit the pocket books of particular plaintiffs."

Thus, the relative financial capabilities of the parties are not relevant to a determination of which party is required to bear

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* In July 1973, the transfer agent estimated that the expense would amount to approximately $16,500 to ascertain the members of the class (A-254, A-222-23, A-225, A-219, A-257, A-239). In view of the inflationary trend of our economy it can be expected that this amount will now be greater. Even if the costs were to remain at $16,500, this is not a trivial amount, especially if the defendants should prevail on the merits and should have to face the problem of seeking to recover such costs from the plaintiffs.

C. The Circumstances of this Case Do Not Warrant any Departure

the expense of class identification for the purpose of notification under Rule 23. As observed in Popkin v. Wheelabrator-Frye, Inc., CCH Fed. Sec. L. Rep. ¶95,068, at p. 97,748 (S.D.N.Y. 1975) (not officially reported), which held that the corporate defendant should not subsidize the expense of notice because it is in a better position to pay than the plaintiffs:

> "Should the corporate defendant in such a suit prevail on the merits after laying out the initial expense of notice to the class, it would in most cases find it impossible to obtain reimbursement."

A. The Identification of Class Members is an Inherent Part of the Notice Procedure and the Cost Therefor Should be Borne by Plaintiffs

Neither Eisen III nor Eisen IV indicate that consideration was given to the question whether the process of identifying class members could or should be treated separate and apart from the notice process. No such separation can be derived from Rule 23(c)(2). On the contrary, that Rule treats identification as an essential component of the requisite notice in that the Court is required to direct to class members the best notice practicable, "including individual notice to all members who can be identified through reasonable effort." Thus, the Rule itself contemplates that the requirements for notice to class members are not separable from the available identification processes.

It must be emphasized that the Supreme Court did not state

The cost of printing the notice, procuring envelopes, stuffing the envelopes and postage for the envelopes have all been considered part of the cost of class notice. E.g., Herbst v. International Telephone & Telegraph Corporation, District Court Opinion reprinted in Appendix, 495 F. 2d 1308, 1324 (2d Cir. 1974). As the majority of this Court observed in its opinion herein, the cost of obtaining the names and addresses to be affixed to the envelope is in no way different from these other costs.

Substantially all of the relatively few cases in point have treated identification costs as a notice cost. While the decisions of the District Courts in the Second Circuit which antedate the decision of this Court in Eisen III sometimes allocated the cost of identification to the defendants, this was done in each case upon the basis of the erroneous view, since rejected, that there was discretionary power to apportion the financial burden of giving notice under Rule 23. We know of no case which has expressly held that the process of ascertaining the names and addresses of members of the class is not an inherent part of the individual notice requirement.

Thus, for example, in Berland v. Mack, 48 F.R.D. 121, 131-33 (S.D.N.Y. 1969), the cost of furnishing notice included the cost of identifying the names and addresses of the members of a class consisting of all transferees of stock of defendant Great

American Industries, Inc. during a specified time period. The identification required, among other things, a search of the transfer sheets kept by the company's transfer agent and communication with brokers acting as nominees for the beneficial owners. The Court allocated to the corporate defendant a portion of "the cost of notice", which was treated by the Court as including the cost of the identification of class members. It did so on the (now impermissible) ground that "the decision as to how the cost of notice is to be allocated between the parties appears to be an appropriate area for exercise of our discretion ..." Id. at 131. (Emphasis supplied.) The Eisen III and Eisen IV decisions have terminated this discretion, but the current significance of Berland is its treatment of the cost of identification as a component of the cost of notice.

In Grad v. Memorex Corporation, 61 F.R.D. 88 (N.D. Cal. 1973), which concerned a class of approximately 60,000 persons who purchased the stock of the named defendant during a stated period and which was decided after Eisen III, the Court and the parties apparently concurred that the cost of identifying members of the class is part of the cost of notice. Said the Court (at p. 103):

> "Plaintiffs here, unlike Mr. Eisen, are willing to bear the full expense of identifying and notifying class members." (Emphasis supplied.)

A recent District Court decision in this Circuit also imposed identification costs on the plaintiff. Herbst v. International Telephone & Telegraph Corporation, District Court opinion reprinted in Appendix 495 F. 2d 1308 (2d Cir. 1974). There, as in the instant case, computer tapes of the defendant corporation contained the identities of members of the class, shareholder-recipients of an exchange offer by defendant. Identification was not imposed on defendants. Defendants there were only required to provide the plaintiffs with "listings or materials in their possession useful for the notification of class members." Id. at 1325. In the instant case, defendants have not sought to withhold such materials in their possession -- that is, the raw materials (tapes) from which class members can be identified. However, the defendants should not be compelled to assume plaintiffs' burden of refining this material in order to effect the identification.

The pre-Eisen opinion in Dolgow v. Anderson, 43 F.R.D. 472, 498-501 (E.D.N.Y. 1968), appears to recognize that the cost of identification is a component of the cost of notice, since it was to minimize notice costs that the Court concomitantly endeavored to limit the costs of identification.

In B & B Investment Club v. Kleinert's, Inc., CCH Fed. Sec. Law Rep. ¶94,451 at pp. 95, 572-73 (E.D. Pa. 1974) (not officially reported), it was unquestioned that the identification of

class members was an integral part of the cost of notice to be borne by plaintiffs; indeed, the Court there ordered "plaintiffs to present the Court with their proposal on how to identify the class members and the cost involved in notice and their ability and willingness to meet those requirements."

In State of Illinois v. Harper & Row Publishers, Inc., 301 F. Supp. 484, 494 (N.S. Ill. 1969), a class action under the antitrust laws involving thousands of school districts and libraries across the nation, it was considered an obligation of the plaintiffs to "prepare a mailing list of all members of their classes." Accord, Lamb v. United Security Life Company, 59 F.R.D. 25, 42-43 (S.D. Iowa 1972); Brennan v. Midwestern Life Insurance Company, 259 F. Supp. 673, 684 (N.D. Ind. 1966).

Although the cases in point are limited in number, there prevails a consistent judicial recognition both before and after the Eisen decisions that the identification of class members is an essential component in the notice procedure under Rule 23 and that the cost of such identification is a constituent of the cost of notice.

B. If Discovery Rules were Applicable, the Cost of Identifying Class Members is Properly Chargeable to Plaintiffs

In dissenting from the Circuit Court's majority opinion herein, Judge Hays expressed the view that the cost of obtaining

the names and addresses of class members is not a notice cost but a discovery cost and therefore could be allocated to defendants. We respectfully submit it is not a discovery cost, and even if it were, it is not properly allocable to defendants.

1. Identifying Class Members for Notice Purposes is Outside the Scope of Discovery

Discovery may not be had beyond the scope authorized under FRCP Rule 26(b), and, except for the matters enumerated therein, discovery is limited to matters "relevant to the subject matter involved in the pending action" or which "appears reasonably calculated to lead to the discovery of admissable evidence."

Thus, Rule 26(b)(1) provides:

> "(b) Scope of Discovery. Unless otherwise limited by order of the court in accordance with these rules, the scope of discovery is as follows:
>
> (1) In General. Parties may obtain discovery regarding any matter, not privileged, which is relevant to the subject matter involved in the pending action, whether it relates to the claim or defense of the party seeking discovery or to the claim or defense of any other party, including the existence, description, nature, custody, condition and location of any books, documents, or other tangible things and the identity and location of persons having knowledge of any discoverable matter. It is not ground for objection that the information sought will be inadmissible at the trial if the information sought appears reasonably calculated to lead to the discovery of admissible evidence." (Emphasis supplied.)

The enumerated additional discoverable matter consists of insurance agreements, trial preparation materials, and facts known and opinions held by experts.

The discovery procedure was designed to enable parties to obtain relevant information bearing on the substantive issues of a litigation, either directly, or indirectly if it might lead to such information. Thus for example, when Rule 26 was amended in 1946 to permit obtaining inadmissible information reasonably calculated to lead to discovery of admissible evidence, the scope of discovery was still focused on the substantive issues of the litigation. See, e.g., Notes of Advisory Committee on Rules, 28 U.S.C.A. Rule 26:

> "Of course, matters entirely without bearing either as direct evidence or as leads to evidence are not within the scope of inquiry ..."

Clearly, information concerning the names and addresses of class members, which is sought for the purpose of enabling plaintiffs to prosecute this as a class action rather than in their individual capacities does not bear at all on the substantive issues of the litigation but is entirely collateral thereto. Such information is not evidence nor is it reasonably calculated to lead to the discovery of admissible evidence.

In his dissent, Judge Hays urges that because discovery is applicable to establish jurisdiction it is equally applicable

for class notice purposes. (Slip Op. p. 4593.) The two cases are not analogous. Jurisdiction, whether over parties or subject matter, is an essential element in every action, and unless conceded is a matter requiring proof by competent evidence either upon pre-trial motion under Rule 12(b) or at the trial. See, e.g., McNutt v. General Motors Acceptance Corp., 298 U.S. 178, 182 et seq (1936).

The history of the discovery permitted with respect to insurance agreements corroborates the view that collateral matter is not discoverable. Prior to the 1970 amendments to the Federal Rules, discovery of such policies were uniformly denied in the Southern District and elsewhere, although permitted in some jurisdictions. See, e.g., Clauss v. Danker, 264 F. Supp. 246 (S.D.N.Y. 1967; Cox v. Livingston, 41 F.R.D. 344 (S.D.N.Y. 1967). The only exception to the rule was the unusual case in which such policies were "... highly relevant to the issues at trial ...". Clauss v. Danker, supra, citing Orgel v. McCurdy, 8 F.R.D. 585 (S.D.N.Y. 1948).

In Clauss, Judge Mansfield recognized that public policy may favor such disclosure, particularly for purposes of the settlement of disputes. Nevertheless, he held that the controlling language of Rule 26(b(1) cited above, supported by the notes of the Advisory Committee, did not extend the scope of discovery

sufficiently to cover the insurance policy in that case, saying (264 F. Supp at 249):

> "...Rule 1, however, does not grant to the Courts latitude to contravene the express provisions of the Rules, and it seems clear that Rule 26(b) contemplates only the discovery of material that could lead to admissible evidence. This conclusion is substantiated by the notes of the Advisory Committee concerning Rule 26 ...
>
> "Under some circumstances, of course, discovery of insurance can be highly relevant to the issues at trial [e.g., where relevant to the issue of ownership or control, citing Orgel, supra], but such is not the case here. There is no connection whatsoever between any insurance policies defendants may have and the merits of the action .. "

As a result of these and other similar decisions, and to effectuate policies which would enable counsel for both sides to base settlement and litigation strategy on knowledge rather than speculation, Rule 26 was amended in 1970 to include a specific provision for discovery of the existence and contents of insurance agreements. See Notes of Advisory Committee, 28 U.S.C.A. Rule 26.

The absence of any specific or general exception for discovery of other collateral matters indicates that information for class notice purposes is outside of the scope of discovery.

2. Even if Discovery Rules were Applicable, Identification of Class Members in the Circumstances Present Here is Properly Chargeable to Plaintiffs

The identification of shareholder accounts which are

members of the class in this action does not involve the production of existing records. Rather, it requires initially the creation of an appropriate series of computer programs and machine processes to scan existing records on tape and to extract and then reproduce the desired pertinent information. The cost of identifying class members results from the necessity to pay for the human and machine services required in the process of devising programs and applying them to obtain the requisite information from the tapes.

Under Rule 33(c) of the Federal Rules of Civil Procedure defendants would not have to bear the cost of devising new computer programs to process the company records in order to identify class members. That subdivision of the Rule is designed to afford protection to parties, such as the defendants here, who have records from which the desired information may be compiled. It provides:

> "(c) Option to Produce Business Records. Where the answer to an interrogatory may be derived or ascertained from the business records of the party upon whom the interrogatory has been served or from an examination, audit or inspection of such business records, or from a compilation, abstract or summary based thereon, and the burden of deriving or ascertaining the answer is substantially the same for the party serving the interrogatory as for the party served, it is a sufficient answer to such interrogatory to specify the records from which the answer may be derived or ascertained and to afford to the party serving the interrogatory reasonable opportunity to examine, audit or inspect such records and to make copies, compilations, abstracts or summaries."

By virtue of Rule 33(c), "ordinarily a party will not be required to 'make research and compilation of data not readily known to him' -- at least if the data is equally available to the interrogating party." 4A Moore's Federal Practice ¶33.20, at p. 33-103 (2d ed. 1974). Similarly, 8 Wright & Miller, Federal Practice and Procedure § 2174 at pp. 552-3 (1971) states:

> "If the data is equally available to both parties, the party seeking the information should do his own research."

This is consonant with the long-standing rule applied in cases predating the prctection expressly afforded under Rule 33(c). Thus, Koncyakowski v. Paramount Pictures, 20 F.R.D. 588 (S.D.N.Y. 1957). There, the Court declared (at p. 593):

> "[T]he general rule is that a party should not be permitted to compel his opponent to make compilations or perform research and investigations with respect to statistical information which he might make for himself by obtaining the production of the books and documents pursuant to Rule 34 of the Federal Rules of Civil Procedure ..."

See also, Tytel v. Richardson-Merrill, Inc., 37 F.R.D. 351 (S.D.N.Y. 1965); Triangle Mfg. Co. v. Paramount Bag Co., 35 F.R.D. 540, 542-43 (E.D.N.Y. 1964); United States v. Renault, Inc., 27 F.R.D. 23, 27-28 (S.D.N.Y. 1960); Erone Corporation v. Skouras Theatres Corporation, 22 F.R.D. 494, 501 (S.D.N.Y. 1958);

United Cigar-Whelan Stores Corporation v. Philip Morris Inc., 21 F.R.D. 107 (S.D.N.Y. 1957).

The defendants have not sought to deny the plaintiffs access to the raw material from which the names and addresses of the members of the class can be ascertained. The defendants' transfer agent is willing to undertake for plaintiffs the task of compiling the relevant names and addresses from this raw data which plaintiffs require to meet their obligations. Since adoption of Rule 33, the discovery rules may not be applied to impose upon the responding party the substantial cost of making a novel compilation from its raw data which is wholly for the benefit of the requesting party and unnecessary to the responding party's preparation of the case.

* * *

Judge Hays, in his dissent (Slip Op. p. 4593, fn. 1) critizes the majority as "somewhat disingenuous" for their focusing on Rule 33, which deals with interrogatories, rather than on Rule 34, which Judge Hays considered "more specifically designed to cover computerized information."

However, Rule 34 is concerned with the production of compilations currently in existence and translations of such existing compilations with printouts. It has no application to the

creation of entirely new programs to work with existing material in order to furnish the necessary information.

In relevant part, Rule 34(a) provides:

> "Any party may serve on any other party a request (1) to produce and permit the party making the request, or someone acting on his behalf, to inspect and copy, any designated documents (including writings, drawings, graphs, charts, photographs, phono-records, and other data compilations from which information can be obtained, translated, if necessary, by the respondent through detection devices into reasonably usable form), or to inspect and copy, test, or sample any tangible things which constitute or contain matters within the scope of Rule 26(b) and which are in the possession, custody or control of the party upon whom the request is served; ..." (Emphasis supplied.)

As Judge Palmieri observed in writing this Court's majority opinion (Slip Op. p. 4588, fn. 7):

> "Our dissenting Brother sees Rule 34 as 'more specifically designed to govern computerized information.' This rule addresses itself to the production of data compilations for inspection or copying, not to the sorting or analysis of the data. Although the rule provides that the data compilation may be 'translated, if necessary, by the respondent through detection devices into reasonably usable form,' the concern appears to focus on putting the data into a form intelligible to the discoverer so he can then study or employ it. As the Advisory Committee Note to the 1970 amendment states,
>
> '[W]hen the data can as a practical matter be made usable by the discovering

> party only through respondent's devices, respondent may be required to use his devices to translate the date into usable form. In many instances, this means that respondent will have to supply a print-out of computer data.'
>
> 48 F.R.D. at 527 (emphasis added). The task of culling relevant names and addresses from a long list, as confronts the parties here, is a distinctly different one from the production for inspection and copying with which Rule 34 is concerned. If 'sophisticated electronic manipulation and analysis' become necessary, 'the courts will have to become increasingly sensitive to problems of expense and the utilization of an opponent's computer assets.' 8 C. Wright and A. Miller Federal Practice & Procedure § 2218 at 659 (1970)." (Emphasis supplied in last 5 lines.)

Because the production of existing computer records will not yield the necessary information, so that straight printouts from such records are of no assistance, Rule 34 is not applicable to the instant action.

* * *

For the reasons hereinabove set forth, the obtaining of information in order to enable plaintiffs to meet class notice requirements is outside the scope of permissible discovery. However, even if discovery were authorized, under the applicable Rule the cost of obtaining such information is properly allocable to plaintiffs. This of course is entirely consistent with the philosophy of the Supreme Court decision in Eisen IV that such costs must be borne by plaintiffs if they wish to obtain the benefits of maintaining the action as a class action.

C. The Circumstances of this Case Do Not Warrant any Departure from the Notice - Cost Rule Established in Eisen IV

Plaintiffs and Judge Hays, in his dissenting opinion, contend that under the decision of the Supreme Court in Eisen IV, a District Court, in its discretion, may make exceptions to the rule there laid down that notice costs are to be paid by plaintiffs if they wish to maintain a class action. They urge this on the basis of the somewhat cryptic reference in one of the concluding paragraphs of Eisen IV, 417 U.S. 156, 178-79, that:

> "The usual rule is that a plaintiff must initially bear the cost of notice to the class. The exceptions cited by the District Court related to situations where a fiduciary duty pre-existed between the plaintiff and defendant, as in a shareholder derivative suit.\15/ Where, as here, the relationship between the parties is truly adversary, the plaintiff must pay for the cost of notice as part of the ordinary burden of financing his own suit."

Footnote fifteen, which annotates this passage, states:

> "See, e.g., Dolgow v. Anderson, 43 F.R.D. 472, 498-500 (EDNY 1968). We, of course, express no opinion on the proper allocation of cost of notice in such cases."

In the two-year period which has elapsed since the Eisen IV decision, we know of no court that has availed itself of this language to impose any part of the cost of notice upon defendants in a class action. We submit is has no application here.

It must be emphasized that the Supreme Court did not state in these few ambiguous words that it recognized any exceptions to the "usual rules" for notice costs. Rather, it stated that the exceptions referred to by the District Court were all distinguishable. The Court then went on to indicate that it expressed no opinion as to proper allocation in situations such as Dolgow. Upon the basis of this, plaintiffs and Judge H[illegible] in his dissent have concluded that since the Supreme Court did not foreclose the possibility of an exception, that Court intended an exception to be made.

The references to stockholder derivative actions and Dolgow, plus the Supreme Court's focus on the adversarial character of Eisen IV, indicate that something more than a fiduciary relationship is required before an exception is to be considered. As Justice Frankfurter remarked, "But to say that a man is a fiduciary only begins the analysis ..." (Securities Commission v. Chenery Corp., 318 U.S. 80, 85 (1942). The references to stockholders derivative actions and Dolgow indicate some of these additional factors. In stockholders derivative actions, the action is brought for the benefit of the corporation, and therefore it is not unreasonable to have it pay for notice when required under FRCP Rule 23.1 in connection with the effects on such benefits of a proposed dismissal or compromise. In Dolgow, the District Court stated it would not "always be unreasonable" to require the defendant to pay when the following three factors were present "in conjunction":-

(1) "a prima facie breach of fiduciary duty has been established";

(2) the defendant has an interest in obtaining the benefits of the

res judicata effects of a judgment; and (3) only the defendant can bear the expense of notice. Dolgow v. Anderson, 43 F.R.D. 472, 499.

The Dolgow decision is not here applicable. In Dolgow, the Court required that a prima facie breach of fiduciary duties be established at a preliminary hearing to show there was "a substantial possibility" that plaintiff would prevail. See 43 F.R.D. at 501. The Eisen IV decision precludes any such mini-hearing on the merits and precludes consideration of ability to pay.

More importantly, in the instant action the crucial issue is not breach of fiduciary duties in any traditional sense but whether, because of alleged erroneous methods of valuation, there was an overvaluation by perhaps up to 10% of restricted securities constituting a minor portion (less than 10%) of the Fund's portfolio, where such valuations were for the purpose of determining the price at which the Fund sold and redeemed its shares and not for the purpose of lining private pockets.

Finally, unlike Dolgow, the defendants here do not consider that res judicata affords them any benefits, let alone benefits sufficient to warrant imposition of notice costs, as evidenced by their consistent opposition to class certification herein as well as their attempts to reduce the size of the class to cover at most one year rather than two.* It is especially anomalous to impose such costs on the defendant Fund. The Fund not only will receive no benefit from the litigation, but in fact it has suffered and will continue to suffer

* Discussed, supra p. 10.

the injuries that normally accrue in litigations, such as litigation expenses, disruption of executives and the intangible effects on reputation and good will when the litigation involves a mutual fund, and indeed it may suffer more tangible injuries in the event plaintiffs should seek to amend their complaint to recover monetary damages from the Fund as well as from the other defendants.

The majority opinion of the Circuit Court herein concluded its discussion of this phase of Eisen IV, by pointing out that the interest of Fund in this litigation is too remote, while for reasons above set forth, Dolgow and other exceptions are not applicable to any of the defendants (Slip Op. pp. 4582-84).*

Since Eisen IV, we know of no decision in which the courts have allocated notice costs to the defendants. Some of the reasons militating against such allocation are well articulated by Judge Cannella in Popkin v. Wheelabrator-Frye, Inc., CCH Sec. L. Rep. ¶95,068 at pp. 97, 747-48 (S.D.N.Y. 1975):

> "While the above pronouncements cannot be said to have dispositively settled the issue, they do limit the alternatives available to the trial court. Although the Supreme Court specifically left open the question of whether or not

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* In Eisen III, the Circuit Court referred to another possible exception - i.e., a class action involving current customers of a public utility, 479 F 2d 1005, 1009, n.5 (2d Cir. 1973), but here the notice is not to be sent to all or substantially all current stockholders but only to those who are members of the class.

there might be certain circumstances in which the usual rule that plaintiff bear the cost of notice might not apply, it did at the same time, definitively reject the contention that a preliminary 'mini-hearing' on the merits was an appropriate device for determining exactly how the cost of notice should be allocated. As a result, any principle on the basis of which costs could be allocated would, of necessity, be an essentially inflexible one. Thus, if it were to be decided that in suits where the defendants owed a fiduciary duty to the plaintiffs, defendants should bear the cost of notice, this principle would have to be applied to all suits where such a pre existing fiduciary duty existed regardless of the size of the class or the strength or weakness of the case. This rule would, of course, be highly inequitable, for as Judge Mansfield aptly stated,

> 'We do not agree that the corporate defendant should be required initially to pay for the notice merely because charges of breach of fiduciary duty are at issue or because it is in a better position to pay than are the named plaintiffs. See Dolgow v. Anderson, 43 F.R.D. 472, 498-99 (E.D.N.Y. 1968). To give a single member of a class who asserts a claim of doubtful merit the power to trigger such a substantial expenditure of corporate funds, without any assurance of joinder on the part of other class members, smacks of confiscation. Should the corporate defendant in such a suit prevail on the merits after laying out the initial expense of notice to the class, it would in most cases find it impossible to obtain reimbursement. See Note, 'Class Actions under Federal Rule 23(b)(3) - The Notice Requirement,' 29 Md. L. Rev. 139, 156 (1969). We doubt that most stockholders expressly or impliedly consent to such a use of corporate funds for vindication of an issue as to fiduciary duty merely because it is raised by one of them.' Berland v. Mack, 48 F.R.D. 121, 131-32 (S.D.N.Y. 1969)."
> (Emphasis supplied.)

Judge Cannella's cautionary words on the difficulties of obtaining reimbursement for costs is corroborated by plaintiffs herein who conceded that even if the Fund prevailed such costs may not be taxable against plaintiffs. (Plaintiffs Brief on Appeal, fn. 1 at p. 59), citing among others 6 Moore's Federal Practice, ¶54.77(1) at p. 1701).

Perhaps the major point espoused by Judge Hays is that of preventing the closure of "yet another door to the class action procedure" (Slip Op. p. 4593). Some of the ill effects of class actions are adverted to in the majority opinion (Slip Op. p. 4584), including the pressure on defendants to settle irrespective of the merits. Others have noted additionally the burdens which such actions place on trial courts because of the complexity of factual issues as to both liability and damages, and the relatively small benefits which accrues to each individual class member on average, as is the case here. However, it is respectfully suggested that desirability of encouraging or discouraging class actions is not a sound basis for deciding how costs should be allocated. The fundamental rule that in our system the defendants should not subsidize a lawsuit against themselves should not be modified by extrinsic considerations. Especially is this true of class actions, which in most cases are brought not for altruistic purposes but to relieve the plaintiffs of some or all ordinary litigation expenses by sharing these with class members.

In the circumstances, we believe the majority of the Circuit Court correctly held that the circumstances here present did not warrant any exception from the Eisen IV rule.

D. The District Court Erred in Concluding that Defendants Sought to Have the Class Defined in a Manner Which Would Substantially Increase the Expense of Class Member Identification

The District Court below erroneously concluded that the defendants' position on class definition resulted in additional expense of class member identification. This conclusion, together with the Court's determination that the costs of identification are "relatively modest", constitute the reasons assigned by the Court for the allocation of such costs to defendant Fund.

In their complaints (A-116-19) plaintiffs sought to represent all persons who purchased shares during the relevant period, and their motion for class certification fixed the period as March 28, 1968 through April 24, 1970. After plaintiffs' motion for class action status had been filed, counsel for plaintiffs took the deposition of the Fund's transfer agent in order to determine the process by which the members of the class could be identified and the costs of such identification for notice purposes and learned therefrom that the cost of approximately $16,500 would be incurred in culling the names and addresses of members of the prospective class.

In May, 1974, the Supreme Court decided Eisen IV. Thereafter plaintiffs urged a modification of the class description to eliminate persons who purchased shares during the relevant period and who were no longer current shareholders of the Fund.* In addition, plaintiffs urged that notice of the class action be included in a regular mailing sent by the Fund to all current shareholders (A-145-47). In their Brief on Appeal (at p. 50), plaintiffs conceded that their attempt to redefine the class was proposed by them primarily to eliminate their incurring identification costs.

The need for and expense of class member identification would have been obviated only if the District Court had adopted both of plaintiffs' proposals for the limited class and for a blanket notice to all current stockholders, since if there were no blanket notice, obtaining names and addresses of purchasers during the relevant period would still be necessary. However, the District Court properly concluded that it would not be appropriate to subject the Fund and its shareholders to the potential hazard of a broadside mailing to all shareholders. The Court had before it the affidavit of Robert G. Galli, Secretary of the Fund

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* As of August 31, 1973, approximately 68,000 then current shareholder accounts (or 40% of the total of 171,195 accounts) were not members of the class and approximately 103,195 were members of the class, leaving approximately 18,000 class members who were no longer current shareholders as of that date. (A-253, Deposition of Investment Company Services Corporation at p. 142-44).

and Administrative Vice President of the Fund's advisor (A-138), that the mutual fund industry and the Fund were in a difficult period in which net redemptions were exceeding sales because of uncertain conditions in the stock market and consequent loss of investor confidence. As was pointed out in the affidavit, it was the experience of the Fund and of the mutual fund industry as a whole that any event which raised questions in the investor's mind in that uncertain climate was likely to cause him to redeem his mutual fund shares. For this reason, any broadside mailing had the potential to trigger a wave of redemptions, like a run on the bank, which might well consume the Fund's liquid assets and require the forced sale of portions of its portfolio. The District Court refused to authorize a mailing which had this potential for damage. It should be borne in mind that such a mailing would not be limited to a few incidental non-class members. On the contrary, even in 1973, approximately 68,000, or more than 40% of all shareholder accounts, were not members of the class. *

Counsel for plaintiffs in both the Circuit and District Courts attempted to minimize the possibilities of harm from the broadside mailing on the ground that shareholders have been advised of this litigation in prospectuses, annual reports and proxy statements. However, the impact of a separately printed class action notice on skittish stockholders is a far cry from that of a brief paragraph description of litigation contained in a comprehensive

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* See fn. at p. 46 herein.

document devoted to other matters. Courts have rightly been sensitive to the impact of class notices sent out under their aegis. See, for example, Dolgow v. Anderson, 43 F.R.D. 472 (E.D.N.Y. 1968), where the Court stated (at 501):

> "[T]he notice provisions themselves may prove harmful to defendants since the attendant publicity and its official source may inflate the apparent importance of the action. [Citations omitted.] So much of the stock market depends upon faith and reputation that the Court should be reluctant to lend its weight to any unnecessary publicity in connection with a pending law suit." (Emphasis supplied.)

The Circuit Court majority opinion herein found that the evidence in the record substantiated defendants' concern and that the concern was legitimate (Slip Op. pp. 4586-87).

Moreover, the method of notice advanced by plaintiffs does not satisfy the express requirements of Rule 23(c)(2) that "the best notice practicable", including individual notice shall be directed "to all members who can be identified through reasonable effort." We know of no court in recent years that has required that notice be sent in a manner that would include a substantial number of nonclass members, where the class members could be identified. Typical Southern District cases which required notice to class members include: Hawk Industries Inc. v. Bausch & Lomb Inc., 59 F.R.D. 619, 625 (S.D.N.Y. 1973); Pearlman v. Gennaro, et al., CCH Fed. Sec. Law Rep., 1973 Decisions ¶94,006 (S.D.N.Y. 1973)

(not officially reported); Ostroff v. Hemisphere Hotels Corp., 60 F.R.D. 459 (S.D.N.Y. 1973); Brandt v. Owens-Illinois, Inc., 62 F.R.D. 160, 166 (S.D.N.Y. 1973); Zachary v. Chase Manhattan Bank, 52 F.R.D. 532 (S.D.N.Y. 1971); and Weiss v. Tenny Corporation, 47 F.R.D. 283 (S.D.N.Y. 1969).

Not only must the notice meet due process requirements, but in determining the "best notice", courts properly should be concerned to avoid unnecessary risk of harm to defendants. This comports fully with the Advisory Committee Notes to Rule 23, 39 F.R.D. 69, at 107, which state that notice is to be employed "for the fair conduct of the action" and not only for the protection of class members.

Plaintiffs heretofore appear to have relied chiefly upon Berland v. Mack, 48 F.R.D. 121, 126 (S.D.N.Y. 1969), in support of their assertion that notice may properly be sent to nonclass members as well as class members. The Berland courtdid not so hold. There, the class was composed of persons who acquired shares of defendant corporation between March 21, 1966 and April 29, 1966. On April 29, 1966, trading in the stock was suspended by the SEC for a six-month period In order to cover purchasers at the end of the period where there had been delays in transfer, the court ordered individual notice by mail to all transferees of record for the period from March 21, 1966 to May 13, 1966. Because of

the suspension of trading, shareholders who were not class members did not receive notice of the action. In fact, the opinion clearly evinces the Court's concern that notice of the action be sent only to class members.

Since blanket notice to all current shareholders was rejected as inappropriate by both District and Circuit Courts, the class modification urged by plaintiffs would not have reduced identification costs. That cost was attributable to the services required to extract from tapes the identity of the names and addresses of all shareholder accounts which purchased Fund shares during the relevant period. The identification of all such purchasers would in any case be required, whether or not it was determined that a notice would be sent to only those of them who remained shareholders as of the date of the mailing and any limitation in the class members on this basis would not eliminate the need for and cost of the initial identification process.

Defendants opposed the reduction of the class in the context of opposing the proposed blanket notice to all current stockholders on the grounds that such blanket notice created a threat of irreparable injury to the Fund. However, the position of the defendants on the issue of class definition did not cause any additional expense in obtaining the names and addresses of the members of the class, and therefore, there is no basis for allocating

any part of the expense of such identification, let alone the whole thereof, to any of the defendants.

POINT II

This Action Is Not Manageable As A Class Action And Should Not Be Maintained As A Class Action

Rule 23(b)(3) of the Federal Rules of Civil Procedure provides that a class action may be maintained only if, among other things, (1) the action involves common questions of law and fact which predominate over questions affecting only individual members, and (2) a class action, taking into consideration the difficulties likely to be encountered in the management of the action, constitutes the best available means to secure a fair and efficient adjudication of the controversy.* The burden of establishing that these requirements have been met is on the plaintiffs. E.g., Boshes v. General Motors Corp., 59 F.R.D. 589 (N.D. Ill. 1973); 3B Moore's Federal Practice ¶23.45[2] at p. 23-761 (2d Ed. 1974). This burden has not been sustained.

The factual basis for concluding that common questions do not predominate and that the difficulties of management in the light of the average size of the recovery preclude fair and efficient adjudication are set forth herein at pp. 7 and 12-16. The legal basis for these conclusions is set forth in our prior main brief on this appeal (at pp. 37-43) and our prior reply brief (at pp. 26-34).

* The text of Rule 23(b)(3) is set forth in the Addendum to this brief.

See also the prior main brief of defendant Fund at pp. 22-25. To avoid unnecessary repetition, we refer this Court to these rather than again set them forth at length herein.* We submit that under applicable legal standards, this action is not properly maintainable as a class action. Our contentions are summarized below.

The gravamen of plaintiffs' claims is that the restricted securities contained in the Fund's portfolio were not valued by the Fund's Board of Directors "at fair value as determined in good faith" under Section 2(a)(41)(B)(ii) of the Investment Company Act of 1940. The ultimate issue is thus whether or not the values as fixed by the directors of the Fund were in fact fair. (See Statement of Case, supra, pp. 12, et seq.). All of the other alleged common questions concern disclosure, but are not at the core of this action. If the Fund's Board of Directors fairly valued the restricted securities in the Fund's portfolio, then the alleged disclosure omissions in the Fund's various publications are simply not actionable. If there were improper valuations, then plaintiffs in effect urge merely that such conduct also is violative of alleged reporting requirements, thereby engendering the appearance but not the reality of a greater number of common questions.

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* In view of the unanimity of the Circuit Court on the issue of appealability and the absence of reference to this issue in plaintiffs' application for rehearing, we do not propose to deal with this further, except to note that the subject is covered in our prior main brief (at pp. 44-47) and reply (at pp. 16-25); in defendant Fund's reply brief (at pp. 2-4).

In fact, common questions do not predominate. Since the gravamen of plaintiffs' claims is that the values attributed to the restricted securities held in the Fund's portfolio were not fair, the alleged liability of the defendants may or may not arise on any one or more of the approximately 500 business days during the class period when Fund shares were sold to members of the class. Such liability obtains only if in the aggregate there was a net overvaluation of the restricted securities on one or more of the 500 days when purchases were made. The discrete questions inherent in "fair value" are, qualitatively and quantitatively, the predominant issues in this case, and such liability is primarily an individual and not a class issue.

These same discrete questions also predominate in connection with the determination of damages. Since Fund shares were sold to class members on each of 500 business days during the class period, proof and findings will be required as to the extent of overvaluation or undervaluation, if any, of each of thirteen different restricted securities on each such date.

In an attempt to mitigate the complexity necessarily involved in these many discrete issues, plaintiffs urged in their Reply Brief to the Circuit Court (at pp. 28,42) for the first time in these proceedings, that the extent of overvaluation for each restricted security could be established through the application

of a standard "percentage discount" to the market price of unrestricted securities of the same type.

This approach to valuation does not obviate the difficulties nor is it entirely consistent with proceedings heretofore had herein. In 1975 plaintiffs responded to certain interrogatories, propounded by defendants two years earlier in 1973, which, among other things, required plaintiffs to state their version of the "daily average true values" of each of the restricted securities in the portfolio of the Fund during the class period. Plaintiffs' answer to this interrogatory covers three pages listing 122 different valuations for these 13 restricted securities during various segments of the class period. (A161-63) Whether or not these 122 valuations are based on a standard percentage discount, we are unable to say. Moreover, we have yet to determine whether this list of valuations is sanctioned by reputable securities analysts or is merely a statement of views held by plaintiffs or their counsel.*

Plaintiffs' advocacy of a fixed percentage discount is also at variance with the principles for valuing restricted securities enunciated by the Securities and Exchange Commission in Investment Company Release No. 5847 (October 21, 1969), CCH Fed. Sec. Law Rep. ¶72,135 at pp. 62,318-19. This Release was cited

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* See supra at p. 14

by plaintiffs in connection with their assertion that "there is....applicable authority supporting plaintiffs' position that the defendants violated the provisions of the Investment Company Act. . . ." (Pltfs. Br. on Appeal at 48n.). Contrary to plaintiffs' views on discounting, the Release states (at p. 62,318): "it would be improper in valuing restricted securities automatically to maintain the same percentage discount (from the market quotation for unrestricted securities of the same class). . . " We may question whether the complex, individual questions inherent in this action may be disregarded when the means now advocated by plaintiffs is condemned by the authority relied on by plaintiffs to establish liability.

There are no cases in which a class suit was allowed to be maintained in the circumstances here present. As is clearly indicated by the Advisory Committee Notes on Rule 23, 39 F.R.D.69 at p. 103, a securities fraud case may be unsuited for treatment as a class action even where there are some common questions, if there will be material variation in the proof of liability because of variations in the representations made or degrees of reliance. Liability in the instant action is predicated on varying valuations in varying combinations of one or more of 13 restricted securities on each of the 500 days when purchases were made.

The aggravated administrative problems of this action

involving 121,000 class members coupled with the relatively small individual damage claims asserted herein, averaging $15 or less,* are precisely the facts relied upon by this Court in dismissing the class action in Eisen III, 479 F. 2d at 1017. Moreover, this action will engender numerous problems which courts have found to militate against class action status: (1) individual proof and findings as to damages; (2) complex individual determinations as to liability; (3) complexities arising from defenses, such as the setoffs asserted by defendants; and (4) the further difficulties of proof occasioned by a jury trial.

Although the body of decisional law treating difficulties in management of class actions is not extensive, the confluence of formidable administrative problems and small individual claims, which the instant action will engender, is of the very type which courts have found to be inimical to class status. Where class aspects necessitate extensive proof and findings of damages to individual members, as it will in the instant case, class action status has been consistently denied on the grounds of lack of

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* See Statement of Case, supra, at pp. 15-16

manageability. Ralston v. Volkswagenwerk, A.G., 61 F.R.D. 427, 431-33 (W.D. Mo. 1973); Cotchett v. Avis Rent A Car System, Inc., 56 F.R.D. 549 (S.D.N.Y. 1972); Lah v. Shell Oil Co., 50 F.R.D. 198 (S.D. Ohio 1970). Similarly, where the trial will be complicated in order to establish liability to members of the class, as in the instant case, class certification has been denied on grounds of unmanageability and predominance of individual questions. E.g., Morris v. Burchard, 51 F.R.D. 530, 535-36 (S.D.N.Y. 1971). Manageability must also take into account the additional trial complexities that will result from the need to adjudicate substantial incremental issues, such as the setoffs asserted by defendants herein. Cotchett v. Avis Rent A Car System, Inc., supra at 553. Moreover, it has been recognized that manageability is also affected by whether or not the action is to be tried to a jury, as in the instant case, since the problems of proof become even more complicated and taxing of judicial resources. Cotchett v. Avis Rent A Car System, Inc., supra at 553-54; Schaffner v. Chemical Bank, 339 F. Supp. 329, 337 (S.D.N.Y. 1972). See City of Detroit v. Grinnell Corp., 356 F. Supp. 1380, at 1388-89 (S.D.N.Y. 1972), mod. 495 F. 2d 448 (2nd Cir. 1974).

It is submitted that the Court below erred in finding that the requirements of Rule 23(b)(3) have been met, and this action should not be permitted to be maintained as a class action.

CONCLUSION

Under the standards established by FRCP Rule 23(b)(3), this action is not authorized to be maintained as a class action. Individual issues predominate over common ones in this case. Moreover, onerous burdens will be imposed on the trial Court and litigants which are not warranted in view of the small amount of damages recoverable on average by individual members.

If, nevertheless, this action is permitted to proceed as a class action, the plaintiffs should be required to pay the costs of identifying the members of the class to whom notice is sent pursuant to FRCP Rule 23(c)(2). The identification of class members is an inherent part of the notice procedure under Rule 23(c)(2) and the cost of such identification must be borne by the plaintiffs as required by the decisions of this Court in Eisen III and of the United States Supreme Court in Eisen IV.

Accordingly, the order of the District Court which is appealed from should be vacated and set aside and the District Court should be directed to enter an order denying plaintiffs' motion dated March 30, 1973 and dismissing the action as a class action; or, in the alternative, if this Court determines that the action is properly maintainable as a class action, so

much of the order appealed from as concerns the cost of identifying class members should be vacated and set aside and the District Court should be directed to enter an order requiring plaintiffs to bear the cost of such identification as part of the costs of notice, pursuant to FRCP Rule 23(c)(2).

Respectfully submitted,

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Of Counsel

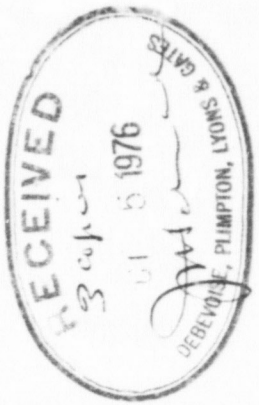
ADDENDUM

FRCP Rule 23(b)(3) provides:

> "(b) CLASS ACTIONS MAINTAINABLE. Any action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition:
>
> (3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action."

FRCP Rule 23(c)(2) provides:

> "(2) In any class action maintained under subdivision (b)(3), the court shall direct to the members of the class the best notice practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort. The notice shall advise each member that (A) the court will exclude him from the class if he so requests by a specified date; (B) the judgment, whether favorable or not, will include all members who do not request exclusion; and (C) any member who does not request exclusion may, if he desires, enter an appearance through his counsel."



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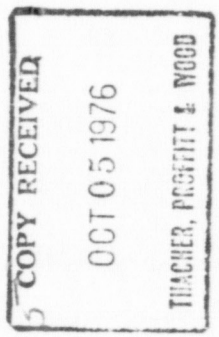

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